News Highlights

Owners. Operators. And Insightful Investors.

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Established in 2007

PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. April 29, 2019

Owner Operated Companies

Facebook, Inc. exceeded profit estimates in the first quarter and set aside $3 billion to cover a settlement with U.S. regulators, calming investors who had worried about the outcome of a months-long federal probe. The settlement accrual, which Facebook set at $3 billion but said could rise as high as $5 billion, cut the company's net income in the first quarter to $2.43 billion, or $0.85 per share. Excluding the charge, Facebook would have earned $1.89 a share, up from $1.69 in the year-ago quarter. Total first-quarter revenue rose 26% to $15.1 billion from $12.0 billion last year. Monthly and daily users of the main Facebook app were both up 8% compared to last year, to 2.4 billion and 1.6 billion, respectively, in line with forecasts. Total expenses in the first quarter were $11.8 billion, including the settlement accrual, up 80% compared with a year ago as the company hired content moderators and invested in new security controls to make its social networks safer. Executives said in a conference call with investors that they expected expenses to grow 47% to 55% this year. The U.S. Federal Trade Commission has been investigating revelations that Facebook inappropriately shared information belonging to 87 million of its users with the now-defunct British political consulting firm Cambridge Analytica. Facebook's largest and fastest-growing user base is now in Asia, where monthly active users jumped 12.4% from last year. Facebook plans to shift focus toward private communications, integrating its messaging services across Facebook, Instagram and WhatsApp.

Fortive Corporation announced results for the first quarter 2019, which included net earnings from continuing operations attributable to common stockholders of $146.7 million. For the same period, adjusted net earnings from continuing operations were $245.6 million. Revenues from continuing operations increased 6.7% year/year to $1.6 billion, with core revenue growth of 3.7%. James A. Lico, President and Chief Executive Officer, stated, "Our first quarter results provided a solid start to 2019, setting us up to deliver another year of strong double-digit earnings growth. Our first quarter performance was in line with our expectations, despite pressures from tariffs, foreign exchange rates, and some near-term headwinds in Professional Instrumentation. We also generated strong free cash flow growth of 31% for the quarter, reflecting the application of the Fortive Business System and the underlying vitality of our portfolio." For the second quarter of 2019, Fortive anticipates diluted net EPS from continuing operations to be in the range of $0.47 to $0.51 and adjusted diluted net EPS from continuing operations to be in the range of $0.86 to $0.90. For the full year 2019, Fortive expects diluted net earnings per share from continuing operations to be in the range of $2.36 to $2.46. For the full year 2019, Fortive expects adjusted diluted net earnings per share from continuing operations to be in the range of $3.55 to $3.65, which includes $0.20 from the Advanced Sterilization Products business. Mr. Lico added, "On April 1st, we closed the acquisition of the Advanced Sterilization Products business from Johnson & Johnson, welcoming the business and its employees to the Fortive family. The $2.7 billion transaction represents Fortive's largest acquisition to date and we are pleased that we closed on time, in just under ten months. With a strong global installed base and leading brands, ASP brings growth, high recurring revenue, and significant earnings potential to the Fortive portfolio."

Energy Sector

Nothing significant to report.

Financial Sector

Barclays PLC: Results - Revenues £5,252 million (-3%); Expenses £3,257 million (-4%) with 61% cost-income which remains best of the European Investment Banks by a large distance. Pretax Profit £1,483 million (-5%). Net Asset Value/share 266 pence. Reiterating >9% return on tangible target for 2019 (implies analysts believe a 10% consensus upgrade). CET 1 capital 13.0%. The case for Barclays includes (i) 4.8% 2019 estimated ordinary yield (35% payout leaves ample room for higher payout vs. Eurobanks sector and Investment Banks (ii) activist shareholder presence may not work but unlikely to hurt, (iii) <60% tangible book valuation vs. 2019 estimated 8-9% return on tangible capital is attractive in analysts' view , (iv) Barclays remains heavily exposed to the worrying leverage lending/ high yield market but if the cycle extends for another year, then there is room for shares to move higher, particularly given year to date underperformance.

Fifth Third Bancorp (FITB) reported Q1 2019 EPS of $1.12. Excluding a $0.49 net benefit, FITB places 'adjusted' EPS at $0.63. Consensus was $0.58. Adjusted EPS excludes (after-tax) a $433 million Worldpay Inc. share gain, partially offset by $24 million drag from Visa Inc. valuation return swaps, and MB Financial, Inc. related charges ($84 million total). Relative to Q4 2018, net interest income was relatively flat reflecting higher average earning assets but lower Net Interest Margin (-1 basis points (bps); lower demand deposits and higher wholesale funding costs); lower fee income (corporate banking); higher expenses (compensation); a lower provision ($13 million reserve build) and Non-Conforming Obligations ratio (-3bps). FITB updated its 2019 guidance to include but reflects no change to standalone income statement growth expectations. In addition, it altered language on how it's looking at its Q4 2019 profitability targets. Now FITB expects a 17%+ ROTCE and sub-56% cost/income efficiency ratio for Q4 2019 (vs. prior expectations of 17.5% ROTCE and sub-55% efficiency ratio).

ING Groep N.V. - At ING's annual general meeting (AGM) last week, shareholders of ING voted against a motion granting executives discharge from legal liability for 2018 in a rare rebuke for the $900 million fine the company incurred in September for failing to prevent money laundering. Under Dutch law, a discharge by shareholders has no formal meaning but will likely be seen by the press and the politicians as a vote of no-confidence. This can have consequences in terms of share price and possibly trigger a chain of events, such as a management change. Separately, Chief executive Ralph Hamers told shareholders last week that the Dutch bank would consider a cross-border takeover under some circumstances, Dutch daily Financieele Dagblad reported. The comments by Hamers at the AGM follow reports that ING has shown interest in acquiring Commerzbank AG if the German bank's ongoing merger talks with Deutsche Bank fail. ING, which is the third largest bank in Germany, and Commerzbank have declined comment on those reports. Hamers also repeated ING's line that it would consider acquisitions to acquire technology or skills it does not have. "But if it should come to a consolidation in one of the markets in which we are active, that would prompt us to a thought process," Financieele Dagblad quoted him as saying. "We would then ask ourselves whether we can grow in that market independently."

The Royal Bank of Scotland Group PLC produced a weak set of Q1 2019 numbers in analysts' view. Profit Before Tax Q1 2019 was £1,013 million, +13% ahead of consensus £900 million. However, driven by low strategic and litigation costs and Impairments. Pre-provision profit excluding these items, £1,328 million, was -13% below £1,529 million consensus. Key driver of the miss was revenue, which was down -8% year/year with both Net Interest Income and Other income missing. Tangible net asset value per share of 289 pence vs. consensus 282 pence or +2% better. Net Interest Margin in Q4 was 1.89% and is down -0.06% in the quarter. Published CET 1 ratio is 16.3% against consensus of 16.3%. Risk Weighted Assets of £191 billion were in line. Management Outlook – demanding environment ("Brexit uncertainty") will make income growth challenging in the near term.

Standard Chartered PLC plans a $1 billion buyback programme after settling with U.S. & U.K. authorities, the Sunday Times reported. Regulatory approval is required but the buyback program could begin at the end of July.

State Street Corporation reported Q1 2019 EPS of $1.18. Excluding 'notable items', EPS was $1.24. Consensus was $1.19. Notable items include $6 million in acquisition & restructuring costs and $14 million in legal costs. Relative to its guidance, fee income did a little better, net interest a little worse and expenses were in-line. Fee income beat was driven by market-related adjustments on employee long-term incentive plans. Revenues declined 4% year/year and fell 3% linked quarter. Expenses rose 1% year/year and declined 8% linked quarter. Excluding notable items, seasonal and Charles River Development related expenses, total expenses were down 2%. Assets Under Custody/Administration increased 3% (higher spot equity market levels, higher client flows) to $32.6 trillion and assets under management jumped 12% (higher spot equity market levels, growth from institutional wins and cash inflows) to $2.8 trillion. Investment Management inflows in Q1 2019 of over $70 billion were driven by institutional and cash inflows. Its CET 1 ratio was 11.5% (-20bps). It repurchased $300 million of common stock in Q1 2019, compared to no buyback in the prior quarter. Average diluted shares declined by 0.5%. It posted an effective tax rate of 20.1%, compared to 16.4% in Q1 2018 and 17.4% in the prior quarter. Compared to Q1 2018 and Q4 2018, the effective tax rate increased due to reductions in benefits attributable to excess stock-based compensation, tax-exempt income and foreign tax credits. Its loan loss provision declined from $8 million to $4 million.

Activist Influenced Companies

Nothing significant to report.

Dividend Payers

AT&T Inc. reported first quarter results, which included total revenue for the quarter up nearly 18% to $44.83 billion, just shy of the expectations for $45.11 billion. AT&T lost a net 544,000 premium TV subscribers, a category that includes DirecTV satellite and U-verse television customers. Pay-TV providers have struggled to keep customers as viewers move to streaming services like Netflix Inc. AT&T has launched its own streaming service. Revenue in AT&T's wireless business was hurt by aggressive smartphone promotions. The company has tried to reduce its dependency on its phone business, which now brings in roughly 40% of total operating revenue, by adding media content through its $85 billion acquisition of Time Warner. AT&T's WarnerMedia unit, which includes Turner and premium TV channel HBO, reported revenue of $8.38 billion in the quarter. The company added a net 80,000 phone subscribers, as it leaned on the smartphone promotions to combat competition in a saturated U.S. market. Mobility, AT&T's largest segment and which includes its wireless business, had revenue of $17.57 billion during the quarter. The carrier has focused on paying down its debt after the purchase of Time Warner. The company paid off $2.3 billion during the first quarter, and net debt now stands at $169 billion. AT&T announced it would sell office space at Hudson Yards in New York City for $2.2 billion, which it plans to use to pay down debt. AT&T previously received $1.43 billion by selling its stake in streaming service Hulu back to the company. Net income attributable to AT&T fell to $4.1 billion, or $0.56 per share, from $4.66 billion, or $0.75 per share, a year earlier. Excluding items, the company earned $0.86 per share, in line with estimates.

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Economic Conditions

U.S. existing home sales fell 4.9% in March to 5.21 million units, a larger-than-expected drop but not enough to dent the prior month's jump when sales rose 11.2% in February (to one-year highs of 5.48 million units annualized). But the details were a little deflating, as all four regions of the country took a hit and both singles and condo-type homes contributed to the drop.

U.S. new home sales rose for the 3rd month in a row, up a consensus-beating 4.5% to 692,000 units annualized in March. With the exception of the Northeast, sales everywhere else rose. Of some caution is that the last 3 months were revised lower, but despite that, sales are now sitting at the highest levels since November 2017. However, supply is still an issue, though not as much as in the existing homes market. Inventories fell for the 2nd straight month, lowering the months' supply to 6.0, though that is still considered "normal". Prices are down 9.7% year/year, and that, along with lower mortgage rates, are helping draw buyers into the market. The breakdown by price-level was not broadly based: the percentage of homes sold at the lower-end of the market (homes priced below $199,999) rose, but those in the mid-range ($200,000-to-$399,999), which make up the majority, edged down.

U.S. Real GDP jumped 3.2% annualized in Q1 after downshifting to 2.2% in Q2. This was well above expectations. However, the increase reflected a massive leap in inventories, a plunge in imports and a spike in state/local government spending. Other than these one-off boosters, the report largely came in as expected in our view. Another upside surprise in intellectual property products investment was offset by a downside miss in residential construction (the fifth straight quarterly decline). The latter will surely reverse in the second quarter given higher housing starts and sales. **Consumer spending downshifted to 1.2%** from 2.5%, largely due to one-off dampeners such as the government shutdown, earlier equity market drama and one of the snowiest winters on record. A strong hand-off from March retail sales and a more recent upturn in (delayed) tax refunds flags an upturn in Q2. Business spending on equipment came to a halt after surging the prior quarter, partly due to trade policy uncertainty and a fading lift from tax cuts and the full expensing allowance. Exports rose, which, coupled with a large drop in imports (largely payback from earlier moves to get ahead of tariffs), provided a 1.0% trade-related lift to GDP.

Ukraine - Fiction blurred into fact as comedian Volodymyr Zelensky was propelled to power as the elected President by Ukranians desperate for action on corruption and falling living standards. But outside observers are largely clueless over his objectives. Mr. Zelensky who plays a character in the local TV hit show Servant of the People rips up Ukraine's International Monetary Fund deal after being thrust to presidential power, but now faces the task of running the country in reality as it fights a 5 year war on the Russian border.

Financial Conditions

Bank of Canada left the overnight rate unchanged at 1.75% last week: while the no-change decision was widely expected, the downgrade to the Bank of Canada's (BoC) 2019 GDP growth forecast for Canada was much larger than anticipated. The BoC's 1.2% forecast for 2019 growth is now well below consensus which is roughly 1.5%. The tone of the statement was more dovish than last March. Gone is the reference to "the timing of future rate increases". The central bank opted to drop its tightening bias, saying instead that it will monitor incoming data to gauge the extent to which factors weighing on growth and inflation are dissipating, in light of which it will evaluate the appropriate degree of monetary policy accommodation. In other words, the BoC opened the door to the possibility of rate cuts in analysts' view, should the second half of the year also disappoint. Analysts believe the central bank will extend its pause through 2019.

The U.S. 2 year/10 year treasury spread is now 0.22% and the U.K.'s 2 year/10 year treasury spread is 0.42% - meaning investment banks remain constrained from profiting from a steep yield curve and instead are seeking operational efficiencies, including job cuts and lower compensation, to maintain acceptable levels of profit, i.e. above costs of capital. Also, the narrowing gap between yields on the 2 year and 10 year Treasuries is of concern given its historical track record that when shorter term rates exceed longer dated ones, such inversion is usually an early warning of an economic slowdown.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 4.20% (was 3.31% end of November 2012, the lowest rate since the Federal Reserve began tracking rates in 1971). Existing U.S. housing inventory is at 3.9 months supply of existing houses. So the combined effects of low mortgage rates, near record high affordability, economic recovery, job creation, and low prices are still supporting the housing market with housing inventory well off its peak of 9.4 months and we believe now at the low end of a more normal range of 4-7 months.

The VIX (volatility index) is 13.06 (compares to a post-recession low of 9.52 achieved in early November) and while, by its characteristics, the VIX will remain volatile, we believe a VIX level below 25 bodes well for quality equities.

Mutual Funds

Portland Investment Counsel Inc. currently offers 8 Mutual Funds:

- Portland Advantage Fund
- Portland Canadian Balanced Fund
- Portland Canadian Focused Fund
- Portland Global Income Fund
- Portland Global Banks Fund
- Portland Global Dividend Fund
- Portland Value Fund
- Portland 15 of 15 Fund

Private/Alternative Products

Portland also currently manages the following private/alternative products:

- Bay & Scollard Development Trust
- ITM AG Investment Trust
- Portland Advantage Plus - Everest Fund
- Portland Focused Plus Fund LP
- Portland Focused Plus Fund
- Portland Global Aristocrats Plus Fund
- Portland Global Energy Efficiency and Renewable Energy Fund LP
- Portland Global Sustainable Evergreen Fund
- Portland Global Sustainable Evergreen LP
- Portland Private Growth Fund
- Portland Private Income Fund
- Portland Special Opportunities Fund
- Portland Value Plus Fund

Individual Discretionary Managed Account Models - SMA

Net Asset Value:

The Net Asset Values (NAV) per unit of our investment funds are published on our Portland website at www.portlandic.com/prices

We want to share our insights with you and welcome your feedback. Our website has the latest, as well as archived videos, company profiles, and press articles. Please visit us at www.portlandic.com.

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Glossary of Terms: 'boe' barrel of oil equivalent, a measurement of a unit of energy, 'boed' refers to barrel of oil equivalent per day, 'CET' core equity tier, 'EBITDA' earnings before interest, taxes, depreciation and amortization, 'EPS' earnings per share, 'FCF' free cash flow, 'GDP' gross domestic product, 'netback' is a measure of oil and gas sales revenues net of royalties, production and transportation expenses and is used to compare performance in the oil and gas industry, 'ROE' return on equity, 'ROTE' return on common equity, 'ROTCE' return on tangible common equity.

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